

Guidance note

COVID-19 and breaking commercial contracts

Under English and Welsh Law, there are several key issues which are likely to arise in relation to contracts as a result of a pandemic and we set out some of the key ones below.

The outbreak of the novel coronavirus COVID-19 has posed significant issues for businesses. The UK Government's move to impose a nationwide lockdown will in particular have a major impact on the ability of many businesses to meet their contractual obligations.

Under English and Welsh Law, there are several key issues which are likely to arise in relation to contracts as a result of coronavirus and we set out some of the key ones below. However, the COVID-19 pandemic is (and the steps which governments are taking in the UK and worldwide are) unprecedented. It is therefore possible that the Courts will in the future take an approach which differs from the current position as a result of the pandemic.

Checking the force majeure clause in your contract

Force majeure has no defined concept in law. It is merely used as a label to refer to clauses which excuse a party from performing their contractual obligations where that performance is significantly affected by events outside of their control, such as natural disasters or war.

It is a common misconception that the outbreak of coronavirus COVID-19 and/or the precautionary steps required by the UK Government to reduce the transmission of the disease are force majeure events. They may be, but that is not automatically the case.

Whether COVID-19 (or any other event) amounts to a force majeure event will depend in every case on the precise wording of the contractual terms

agreed between the parties, alongside consideration of the particular nature of the contract concerned.

Many force majeure clauses will include a list of specific events which the parties have agreed will amount to force majeure, entitling the parties to cease performing some or all of their obligations under the contract. Whether COVID-19, or any other pandemic/illness, is included will depend on the particular wording of the clause.

In addition to a specific list of events, a force majeure clause may also include 'sweep-up' wording along the lines of 'events of a similar nature to those listed'. Whether events arising as a result of COVID-19 will be of 'a similar nature' to the events listed will be a question of fact based on the surrounding wording of the contract. For example, events arising as a result of COVID-19 will not usually be 'of a similar nature' to those arising from fire or flood.



Does your contract refer to 'Acts of God'?

Some contracts include references to 'Acts of God'. Sometimes this is defined by reference to specific events or types of events, and sometimes not.

Where it is undefined, the term has been interpreted by the Courts as amounting to 'extraordinary' incidents which occur due to natural causes, without human intervention, and which could not have been foreseen. This has generally included natural disasters, such as earthquakes and floods, but it is possible that it could include a pandemic (including COVID-19); assuming the wording of the contract itself supports this.

However, the position for COVID-19 is currently untested and it should not be assumed that the Courts will conclude that COVID-19 falls within the scope of this term. It is too early to draw a firm conclusion on what might be determined about the cause of the pandemic and the extent to which it could have been foreseen.



Impact of force majeure

The impact of a force majeure event is often dealt with in the contract itself and again varies on a case-by-case basis. Sometime the wording of the contract may excuse non-performance of all of a party's contractual obligations. Alternatively, it may limit its effect to certain specified obligations, or may simply delay or extend the period to perform those obligations.

It is important to note that the contract may also contain specific procedures that must be followed if a party wishes to rely upon a force majeure event. These can include specific notice requirements or other steps a party is obliged to take. If such a provision exists, a party wishing to rely on a force majeure event must ensure that it follows the correct procedure or risk losing the right to rely upon force majeure to excuse performance of their obligations.

Frustration – a potential alternative to force majeure

A contract is 'frustrated' when it becomes impossible to perform. If a contract does not contain any terms dealing with force majeure, a party might be able to assert that the contract has been frustrated because it is impossible to perform its obligations, or that performance would be radically different to what was agreed.

There is a very high bar to proving that a contract has been frustrated. It is not enough for a party to rely on frustration simply because it has become commercially undesirable for it to perform its contractual obligations.

Where a contract is frustrated the parties will be discharged from their future obligations.

Illegality – could performance of your contractual obligations go against Government imposed restrictions?

Where obligations under a contract result in an outcome which goes against Government imposed restrictions, contracting parties may seek to rely on 'illegality' to excuse non-performance. Again, it is a high bar to prove that performance of a contract is illegal. The Courts start from a presumption that a contract is lawful and will prefer to construe it in such a way.

It is possible, however, that this argument may become increasingly relevant to a range of contracts following the recent Government imposed lockdown. The requirement for certain businesses to close, restrictions on the movement of individuals, the advice to limit 'unnecessary' travel and the banning of certain events could lead to claims that contractual performance would be illegal. Given the Courts' case-by-case approach, it is vital to consider the precise wording and scope of parties' contractual obligations before taking decisive steps, however.

Other relevant contractual provisions

It is advisable at this time to review the terms of existing contracts to see if there are any other provisions that may be affected by the circumstances arising from COVID-19. For example: is there likely to be an impact on KPIs and/or other targets being met, and what is the effect, if any, if those terms are breached? Are there obligations to report in the event of a failure to meet certain obligations? Are there obligations to notify anyone if key personnel are taken ill/unavailable for work, and what are the effects of this?

Insurance

It is also sensible to consider what insurance policies are in place. There may be policies that potentially cover losses suffered as a result of COVID-19. As with all other contracts, however, the question of whether cover is provided in relation to COVID-19 will come down to the particular policy wording and any specified exclusions.

It is also important to check what notification requirements there are under any insurance policies - these will usually require the insured to notify the insurer of a claim, or potential claim, within a specified time. Consequently, even if it is unclear at this stage whether you will need to seek to rely on a policy, or whether COVID-19 related issues are covered, it may be advisable to notify an insurer of a potential claim at this stage.

Additional steps to take

The situation around COVID-19 is rapidly evolving. It is important to keep up-to-date with guidance and maintain clear records.

If you are engaging in commercial discussions with other contracting parties to manage the situation, ensure you keep a clear written record of any conversations. It is helpful to summarise any oral communications you have in a follow up email, for example, which can then act as a written, timed, record of any agreed arrangements.

Keep detailed and contemporaneous records of the impact COVID-19 is having on the operation of your business. For example, if there is a reduction in revenue caused by a drop in the number of customers, difficulties in sourcing supplies, staffing issues, etc.

Be aware of the latest UK Government guidance by monitoring the Government website (<https://www.gov.uk/coronavirus>) and consider how any changes may impact on the operation of business.

If you would like further guidance or information mentioned above, we would be happy to help.

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